

**Inequality, Welfare, Household Composition and Prices**  
**A Comparative Study on Australian and Canadian Data**

**By**

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## **Declaration**

This thesis contains no material which has been accepted for the award of any other higher degree or graduate diploma in any university, and, to the best of my knowledge and belief, contains no material previously published or written by another person, except when due reference is made in the text of the thesis.

.....  
Paul Andrew Blacklow  
June 2002

## **Statement of Authority of Access**

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The Australian price and 1998-99 Household Expenditure Survey data were made available through the agreement between the Australian Bureau of Statistics (ABS) and the Australian Vice-Chancellors' Committee (AVCC). All survey data used in this thesis was confidentialised by the appropriate statistical agency before being obtained.

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## **Abstract**

This thesis examines and compares the nature, magnitude and movement in the inequality of income and expenditure of Australian households from 1975-76 to 1998-99 and Canadian households from 1978 to 1992. The inequality of welfare impacts on an individual's feelings of belonging and participation in society and the level of social division within it. It may have such tangible effects as political unrest and increased crime. This raises the issue of, what is happening to the inequality of welfare and how to measure household welfare and inequality?

The thesis considers the normative judgements made in measuring the inequality, desirable properties of inequality indices and the appropriate variable to represent household welfare. It finds in favour of expenditure as a more appropriate measure of a household's living standards than income and that equivalence scales and cost of living indices should be used to account for variation in household composition and prices.

The majority of past studies of Australian and Canadian inequality report an increase in income inequality throughout the latter half of the 20<sup>th</sup> century. However, the timing and size of increase is dependent upon the inequality indices, equivalence scales and sample selection used in each study. While many studies have focussed on the distribution of income, few have considered the inequality of expenditure or the explicit role of prices in inequality movements via a cost of living index. The thesis specifies a demographically extended complete demand system and uses household survey and price data to obtain estimates of its parameters to construct and compare alternate equivalence scales and demographically varying cost of living indices.

The independence of the equivalence scale to reference utility was found not to hold suggesting that welfare comparisons between households of varying demographic types will be dependent on the specification of the household cost function. While the estimated price elasticities vary significantly across households, prices of commodity groups have moved such that the change in the cost of living over time is relatively uniform across households.

The thesis finds that the real adult equivalent disposable income inequality of households has been rising in Australia consistently from 1975-76 to 1998-99, while real adult equivalent expenditure inequality recorded a fall over the period as a whole. In contrast, the inequality of Canadian household real adult equivalent disposable income and expenditure, have moved together, rising from 1978 to 1986 before falling in 1992. Australia has a higher magnitude of inequality in the distribution of household equivalent expenditure compared to Canada. The decline in the inequality of accommodation expenditure has been significant for Australia and Canada in offsetting the rise in inequality of expenditure on food and alcohol and tobacco. The rise in wage inequality and to a lesser extent investment income inequality, have largely accounted for the rise in gross income inequality in both countries.

The thesis finds that the movement in Australian inequality is not overly sensitive to equivalence scale specification, although Engel, OECD and per capita scaled welfare tend to exaggerate the movement when compared to demand system based scales. In Canada from 1982 to 1986 changes in household composition resulted in significant difference in the movement of inequality estimates for different equivalence scales. The Engel, OECD and per capita based estimates showed a fall in inequality in contrast to the demand system based scales. The magnitude and the movement in inequality for both countries are insensitive to the

specification of price indices. Excluding observations from the original sample can have extreme consequences on the reported magnitude and trend in inequality.

By exploiting the additive decomposability property of inequality, the employment status and education level of the household head for Australia and Canada respectively, were found to have a large effect on the magnitude and movement in inequality. Age of the household head and the demographic type of the household were found to explain less than a sixth of the magnitude and trend in household inequality for both Australia and Canada.

To summarise, this thesis makes the following contributions:

### **Methodological**

- i) It considers the normative judgements made in measuring inequality, the desirable properties of inequality indices and the appropriate variable to use to represent household welfare.
- ii) It accounts for differences amongst the demographic composition of households by using equivalence scales based upon an explicitly defined demographic extended demand system.
- iii) It accounts for price movements by developing a cost of living index based upon an explicitly defined demographic household cost function and complete demand system.

### **Empirical**

- i) Real adult equivalent disposable income inequality of households has been rising in Australia consistently from 1975-76 to 1998-99, while real adult equivalent expenditure inequality recorded a fall over the period as a whole.
- ii) In contrast Canadian household real adult equivalent disposable income and expenditure inequality have moved together, rising from 1978 to 1986 before falling in 1992.
- iii) The movement in Australian and Canadian inequality is not overly sensitive to different demand system based scales but Engel, OECD and per capita scaled estimates tend to exaggerate the movement of Australian inequality and report movements in Canadian inequality from 1982-1986 reverse to the demand system based scales.

- iv) The magnitude and the movement in inequality for both countries are not very sensitive to the specification of price indices. However there is evidence that regional price movements in Canada have helped to offset inequality, while allowing for differing price impacts across households using the CLI reduces this effect. For Australia price movements appear to have reduced the fall in expenditure inequality and increased the rise in income inequality slightly.
- v) Excluding observations from the original sample can have extreme consequences on the reported magnitude and trend in inequality.
- vi) Employment status and education level of the household head for Australia and Canada respectively, were found to have a large effect on the magnitude and movement in inequality. Greater than, what could be explained by decomposing by age of the household head or the demographic type of the household.

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## Contents

Declaration .....	ii
Statement of Authority of Access .....	ii
Abstract .....	iii
Acknowledgments .....	vii
Contents .....	ix
Chapter 1 Introduction.....	1
1.1 Economics and Inequality .....	3
1.2 Motivation .....	7
1.2.1 Inequality .....	8
1.2.2 Impact of the Measurement of Real Equivalent Welfare on Inequality .....	10
1.2.3 Identification of Factors Responsible for Inequality .....	12
1.3 Methods .....	13
1.4 Structure of the Thesis .....	14
Chapter 2 The Measurement of Inequality .....	17
2.1 Interpersonal Comparability and Social Welfare Functions .....	18
2.1.1 Utilitarianism .....	19
2.1.2 The Rise of Ordinality .....	20
2.1.3 Pareto Optimality and Ordinal Social Welfare Ordering .....	20
2.1.4 The Bergsonian Social Welfare Function .....	21
2.1.5 Social Welfare Functionals and Arrow's Impossibility Theorem .....	22
2.1.6 The Bergson-Samuelson Individualistic Social Welfare Function .....	22
2.1.7 Possible Social Welfare Functions for Inequality .....	23
2.1.8 Possible Non-Individualistic Social Welfare Functions for Inequality .....	26
2.1.9 The Relationship between <i>SWF</i> and Inequality .....	27
2.2 Measuring Inequality .....	29
2.2.1 Desirable Properties of Measures of Inequality .....	29
2.2.2 Statistical Measures of Inequality .....	35
2.2.3 Social Welfare Function based Measures of Inequality .....	38
2.2.4 Axiomatic Measures of Inequality .....	41
2.3 Measures of Individual Welfare .....	45
2.3.1 Current Income as a Measure of Welfare .....	46
2.3.2 Consumption and Expenditure as a Measure of Welfare .....	48
2.4 Inequality, SWF, Price and Household Composition .....	53
2.4.1 Inequality Defined over Utilities on Nominal Welfare .....	55
2.4.2 Prices Independent Inequality Defined over Utilities on Nominal Welfare .....	56
2.4.3 Inequality Defined over Utilities on Real Welfare .....	58
2.4.4 Inequality Defined over Utility on Money Metric Welfare .....	58
2.5 Summary of Key Points .....	59
Chapter 3 A Review of Australian and Canadian Inequality .....	62
3.1 Trends in International Inequality .....	62
3.2 Canadian Inequality .....	66
3.2.1 Long Term Trends in Canadian Inequality and Income Shares .....	67
3.2.2 Unemployment and Canadian Income Inequality .....	69
3.2.3 Canadian Wage Inequality .....	71
3.2.4 Canadian Income Inequality in More Detail .....	72
3.2.5 Canadian Expenditure Inequality .....	74
3.3 Australian Inequality .....	75
3.3.1 Australian Wage Inequality .....	75
3.3.2 The 20 <sup>th</sup> Century: Long Run Changes in Inequality .....	76
3.3.3 The Modern Era: The Availability of Household and Family Data .....	78
3.3.4 Australian Expenditure Inequality .....	84
3.4 Summary of Key Points .....	85

Chapter 4 Household Composition and Prices.....	87
4.1 Household Composition.....	87
4.1.1 Unit of Analysis.....	88
4.1.2 Equivalence Scales .....	91
4.1.3 Australian and Canadian Equivalence Scales .....	114
4.2 Prices .....	125
4.2.1 Fixed Bundle Price Indices .....	126
4.2.2 Consumer Price Indices .....	128
4.2.3 Cost of Living Indices.....	131
4.2.4 Dependence of the CLI on Base Utility .....	133
4.2.5 Demographics, Equivalence Scales and the CLI .....	133
4.2.6 Practical Implementation of a CLI.....	134
4.3 Summary of Key Points .....	135
Chapter 5 Data and Estimation.....	138
5.1 Australian Data.....	138
5.1.1 Household Expenditure Survey (HES) .....	139
5.1.2 Problems and Adjustments made to HES Data.....	141
5.1.3 Australian Price Data .....	143
5.2 Canadian Data .....	146
5.2.1 Family Expenditure Survey (FES).....	146
5.2.2 Problems and Adjustments made to FES Data .....	149
5.2.3 Canadian Price Data .....	150
5.3 Measurement Error and Sample Selection .....	152
5.4 Estimation.....	155
5.5 Basic Statistics from the HES and FES.....	156
5.5.1 Budget Shares .....	156
5.5.2 Mean Household Size Demographics.....	157
5.5.3 Mean Household Real Expenditure, Disposable and Gross Income.....	158
5.6 Summary of Key Points .....	160
Chapter 6 Specification and Estimation of Equivalence Scales and Price Indices ..	163
6.1 Demand System Specification.....	164
6.2 Equivalence Scale Specification .....	166
6.2.1 The Equivalence Scale: Functional Form .....	167
6.2.2 The Equivalence Scale: Parameter Estimation and Specification.....	170
6.2.3 Generalised Cost Scaling Test of <i>IB</i> .....	173
6.3 Estimated Equivalence Scales and <i>IB</i> Tests.....	175
6.3.1 Australian and Canadian Equivalence Scale Estimates .....	175
6.3.2 Tests of the <i>IB</i> (independent of base utility) Assumption.....	181
6.4 The QAIDS Cost of Living Index .....	183
6.5 The Effect of Individual Price Changes Upon Measures of Real Welfare .....	185
6.6 Empirical Price Effects upon the PS-QAIDS CLI .....	191
6.7 Summary of Key Findings .....	196
Chapter 7 Empirical Evidence on Income and Expenditure Inequality .....	198
7.1 Movement in Australian and Canadian Inequality.....	198
7.1.1 Australian Inequality .....	198
7.1.2 Canadian Inequality .....	204
7.1.3 Australian v Canadian Inequality - A Comparison .....	207
7.2 Sensitivity of Inequality Estimates to the Equivalence Scale .....	213
7.2.1 Sensitivity of Australian Inequality to the Equivalence Scale .....	215
7.2.2 Sensitivity of Canadian Inequality to the Equivalence Scale.....	218
7.3 Sensitivity of Inequality Estimates to the Price Deflator .....	221
7.3.1 Sensitivity of Australian Inequality to the Price Index .....	221
7.3.2 Sensitivity of Canadian Inequality to the Price Index.....	223
7.4 Sensitivity of Inequality Estimates to Sample Exclusion.....	225
7.4.1 Sensitivity of Australian Inequality Estimates to Sample Exclusion.....	226
7.4.2 Sensitivity of Canadian Inequality Estimates to Sample Exclusion .....	228

7.5	Summary of Key Findings .....	231
Chapter 8 Inequality Decomposition.....235		
8.1	Decomposition by Age of Household Head.....	237
8.1.1	Australian Decomposition by Age of Household Head.....	238
8.1.2	Canadian Decomposition by Age of Household Head .....	243
8.1.3	Australian and Canadian Decomposition by Age of Household Head .....	245
8.2	Decomposition by Household Type .....	247
8.2.1	Australian Decomposition by Household Type .....	248
8.2.2	Canadian Decomposition by Household Type.....	251
8.2.3	Australian and Canadian Decomposition by Household Type .....	254
8.3	Other Decompositions.....	255
8.3.1	Australian Decomposition by Household Head's Employment Status.....	255
8.3.2	Canadian Decomposition by Household Head's Education Status.....	259
8.4	Summary of Key Results.....	263
Chapter 9 Summary and Conclusion.....265		
9.1	Summary of the Thesis.....	267
9.2	Limitations and Directions for Future Research .....	273
9.3	Conclusion.....	274
References .....		
Appendices .....		
Appendix 2 for Ch 2 The Measurement of Inequality .....		
Appendix 2.1 Basic Desirable Properties of the General SWF.....		
Appendix 2.2 Additional Properties to allow the construction of a SWFL.....		
Appendix 2.3 The Degree of Comparability and the <i>SWF</i> .....		
Appendix 2.4 Statistical Measure of Inequality .....		
Appendix 5 for Ch 5 Data and Methodology .....		
Appendix 6 for Ch 6 Household Composition and Prices .....		
Appendix 7 for Ch 7 Empirical Evidence on Income and Expenditure Inequality..		

## Figures

Figure 1.1	Flow Chart Of Concepts.....	2
Figure 2.1	The Social Welfare Approach to Measuring Welfare .....	18
Figure 2.2	SWF and Inequality.....	28
Figure 2.3	Symmetric Measures of Inequality.....	29
Figure 2.4	Convex Measures of Inequality and Concave SWF .....	31
Figure 2.5	Mean Independent Measures of Welfare.....	32
Figure 2.6	The Gini and Lorenz Curves .....	38
Figure 4.1	An Illustration of Different Units of Analysis.....	90
Figure 4.2	Engel's Model for Measuring Equivalence Scales.....	94
Figure 5.1	Australian Price Indices by Expenditure Group .....	145
Figure 5.2	Australian Annual Inflation Rates by State .....	145
Figure 5.3	Canadian Price Indices by Expenditure Group.....	151
Figure 5.4	Canadian Annual Inflation Rates by Region .....	152
Figure 5.5	Australian Budget Shares .....	156
Figure 5.6	Canadian Budget Shares.....	157
Figure 7.1	Australian versus Canadian $I_0$ Inequality .....	208
Figure 7.2	Australian versus Canadian $I_1$ Inequality .....	208
Figure 8.1	Australian and Canadian Population Shares: by Age of Household Head (HDAGE).....	238
Figure 8.2	Australian Real Equivalent Disposable Income and Expenditure Inequality: by Age of Household Head.....	241
Figure 8.3	Canadian Real Equivalent Disposable Income and Expenditure Inequality: by Age of Household Head.....	245
Figure 8.4	Australian and Canadian Population Shares: by Household Demographic Type (HHT).....	248

Figure 8.5 Australian Real Equivalent Disposable Income and Expenditure Inequality: by Household Type .....	251
Figure 8.6 Canadian Real Equivalent Disposable Income and Expenditure Inequality: by Household Type .....	253
Figure 8.7 Australian Population Shares: by Employment of Household Head.....	256
Figure 8.8 Australian Real Equivalent Disposable Income and Expenditure Inequality: by Employment Status of Household Head. ....	259
Figure 8.9 Canadian Population Shares: by Education of the Household Head (HDED) .....	260
Figure 8.10 Canadian Real Equivalent Disposable Income and Expenditure Inequality: by Education Status of Household Head.....	262
Appendix Figure 2.1 Intersecting and Non-Intersecting Lorenz Curves .....	292

## Tables

Table 2.1 SWF allowed by Degree of Welfare Comparability by Desirable Properties of the SWF ...	25
Table 3.1 Distribution of Family Income from Six Countries .....	64
Table 3.2 OECD countries ranked in descending order by income inequality in the mid 1980s .....	65
Table 3.3 Changes in Gini Coefficients of Gross Income .....	66
Table 3.4 Long-Term Trends in The Income Distribution of Canada .....	68
Table 3.5 Quintile shares of total income in Canada.....	68
Table 3.6 Estimates of the Distribution of Individual Gross Incomes (decile shares).....	78
Table 3.7 The Australian Distributions of Gross Income, Net Income and Equivalent Net Income for Individuals 1981-82 to 1989-90 of individuals .....	83
Table 4.1 Mean Incomes and Inequality Measures for Different Units of Analysis.....	91
Table 4.2 Summary of Early Equivalence Scale Models .....	104
Table 4.3 Administrative, Budgetary and International Scales for Australia .....	117
Table 4.4 Binh and Whiteford's Detailed <sup>a</sup> Engel Equivalence Scales <sup>b</sup> .....	119
Table 4.5 Lancaster and Ray's Detailed PS-QAIDS and PS-LES Equivalence Scales .....	120
Table 4.6 A Comparison of Estimated Australian Equivalence Scales .....	121
Table 4.7 A Comparison of Canadian Equivalence Scales.....	123
Table 4.8 Price Sensitive Equivalence Scales, Evaluated at mean prices.....	125
Table 5.1 HES Sample Size and Population.....	139
Table 5.2 Expenditure Category Specification in terms of the HES and CPI groups .....	140
Table 5.3 FES Sample Size and Population .....	148
Table 5.4 Expenditure Category Specification in terms of the FES and CPI groups.....	148
Table 5.5 A Comparison of the Definitions Between Australian and Canadian Child/Dependent Categories .....	150
Table 5.6 Mean Household Size Demographics.....	158
Table 5.7 Mean Real Household Expenditure, Disposable and Gross Income.....	159
Table 5.8 Macroeconomic Statistics for Australia and Canada .....	159
Table 6.1 Australian Estimated Equivalence Scale Parameters.....	176
Table 6.2 Australian Estimated Equivalence Scales <sup>1</sup> .....	178
Table 6.3 Canadian Estimated Equivalence Scale Parameters .....	179
Table 6.4 Canadian Estimated Implied Equivalence Scales <sup>1</sup> .....	180
Table 6.5 Tests of the IB parameter for Australia and Canada.....	181
Table 6.6 Australian Price Elasticity of the CLI in the Base Period across Real Equivalent Expenditure .....	188
Table 6.7 Canadian Price Elasticity of the CLI in the Base Period across Real Equivalent Expenditure .....	188
Table 6.8 Demographic Variations in the Australian Price Elasticity of the CLI.....	190
Table 6.9 Demographic Variations in the Canadian Price Elasticity of the CLI .....	191
Table 6.10 Australian PS-QAIDS CLI and CPI .....	192
Table 6.11 Canadian PS-QAIDS CLI and CPI.....	193
Table 6.12 Substitution, Income and Demographic Effects of Australian Price Movements 1975-76 to 1998-99 .....	194
Table 6.13 Substitution, Income and Demographic Effects of Canadian Price Movements 1978 to 1992 .....	195
Table 7.1 Australian Expenditure Inequality Estimates .....	199
Table 7.2 Australian Disposable Income Inequality Estimates .....	200
Table 7.3 Canadian Expenditure Inequality Estimates .....	205
Table 7.4 Canadian Disposable Income Inequality Estimates .....	206
Table 7.5 Australian v Canadian I <sub>0</sub> Inequality of Expenditure by Commodity .....	209
Table 7.6 Australian v Canadian I <sub>0</sub> Income Inequality by Source.....	211

Table 7.7 Australian $I_1$ Real Equivalent Expenditure Inequality Estimates .....	216
Table 7.8 Australian $I_1$ Real Equivalent Disposable Income Inequality Estimates .....	217
Table 7.9 Canadian $I_1$ Real Equivalent Expenditure Inequality Estimates .....	218
Table 7.10 Canadian $I_1$ Real Equivalent Disposable Income Inequality Estimates .....	220
Table 7.11 Australian $I_1$ Equivalent Expenditure Inequality Estimates by Price Index.....	222
Table 7.12 Australian $I_1$ Equivalent Disposable Income Inequality Estimates by Price Index .....	223
Table 7.13 Canadian $I_1$ Equivalent Expenditure Inequality Estimates by Price Index .....	224
Table 7.14 Canadian $I_1$ Equivalent Disposable Income Inequality Estimates by Price Index .....	225
Table 7.15 Australian $I_1$ Real Equivalent Expenditure Inequality Estimates by Sample Exclusion...	227
Table 7.16 Australian $I_1$ Real Equivalent Disposable Income Inequality Estimates by Sample Exclusion.....	228
Table 7.17 Canadian $I_1$ Real Equivalent Expenditure Inequality Estimates by Sample Exclusion ....	229
Table 7.18 Canadian $I_1$ Real Equivalent Disposable Income Inequality Estimates by Sample Exclusion .....	230
Table 8.1 Australian Within and Between Inequality by Age of Household Head (HDAGE).....	239
Table 8.2 Trend in Australian Inequality by Age of Household Head (HDAGE).....	240
Table 8.3 Canadian Within and Between Inequality by Age of Household Head (HDAGE) .....	243
Table 8.4 Trend in Canadian Inequality by Age of Household Head (HDAGE) .....	244
Table 8.5 Australian Within and Between Inequality by Household Type (HHT).....	249
Table 8.6 Trend in Australian Inequality by Household Type (HHT).....	249
Table 8.7 Canadian Within and Between Inequality by Household Type (HHT) .....	252
Table 8.8 Trend Canadian in Inequality by Household Type (HHT) .....	252
Table 8.9 Australian Within and Between Inequality by Household Head's Employment Status (HDEMP).....	257
Table 8.10 Trend in Australian Inequality by Household Head's Employment Status (HDEMP).....	258
Table 8.11 Canadian Within and Between Inequality by Household Head's Education Level (HDED) .....	261
Table 8.12 Trend in Canadian Inequality by Household Head's Education Level (HDED) .....	261
Appendix Table 5.1 Australian Prices for HES Expenditure groups re-based to 1988-89 by State and Territory .....	293
Appendix Table 5.1 Australian Prices for HES Expenditure groups re-based to 1988-89 by State and Territory (continued).....	294
Appendix Table 5.2 Canadian Prices for FES Expenditure groups re-based to 1988-89 by Province	295
Appendix Table 6.1 Australian Demand System Estimates .....	296
Appendix Table 6.2 Australian Demand System: PS-AIDS Cross Price Term Estimates .....	298
Appendix Table 6.3 Australian Demand System: GCS-AIDS Cross Price Term Estimates .....	298
Appendix Table 6.4 Australian Demand System: PS-QAIDS Cross Price Term Estimates .....	299
Appendix Table 6.5 Canadian Demand System Estimates.....	300
Appendix Table 6.5 Canadian Demand System Estimates (continued) .....	301
Appendix Table 6.6 Australian Demand System: PS-AIDS Cross Price Term Estimates .....	302
Appendix Table 6.7 Australian Demand System: GCS-AIDS Cross Price Term Estimates .....	302
Appendix Table 6.8 Australian Demand System: PS-QAIDS Cross Price Term Estimates .....	303
Appendix Table 6.9 Expenditure Classes .....	303
Appendix Table 7.1 Australian Real Equivalent Expenditure using PS-QAIDS Equivalence Scale and CLI.....	304
Appendix Table 7.2 Australian Real Equivalent Disposable Income using PS-QAIDS Equivalence Scale and CLI.....	305
Appendix Table 7.3 Canadian Real Equivalent Expenditure using PS-QAIDS Equivalence Scale and CLI.....	306
Appendix Table 7.4 Canadian Real Equivalent Disposable Income using PS-QAIDS Equivalence Scale and CLI.....	307